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C O N F I D E N T I A L SECTION 01 OF 02 RPO DUBAI 000009

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TAGS: PGOV IR ECON PREL
SUBJECT: IRAN BANKING ON ROPES AS BAD LOANS HIT RECORD HIGH

CLASSIFIED BY: Alan Eyre, Director, DOS, IRPO; REASON: 1.4(B), (D), (E)

¶1. (C) SUMMARY: A January 3 Central Bank of Iran (CBI) report indicates non-performing loans (NPLs) jumped from USD 40 billion to 48 billion from mid-September to mid-November. NPLs now account for nearly 26 percent of all outstanding domestic loans. CBI ascribed the increase in bad loans to the domestic effect of the general global economic slowdown, and expects this trend to continue. Over the last six months Iran's General Inspections Organization (GIO) has warned that bad loans are on the rise, blaming it at least partially, on questionable lending methods and state-owned banks' incompetence in collecting. One IRPO business contact hypothesized that so many loans in recent years were insufficiently collateralized, sometimes only by letters from state-backed institutions like the IRGC, most banks can not collect if loans go bad. Ahmadinejad's political opponents sought to lay the blame at his feet, citing Executive branch interference and political favoritism in lending. In the absence of any change in government policy, the CBI and state-owned banks are responding by cutting liquidity and making new loans difficult to obtain. These actions will most hurt legitimate, domestic businesses and investors in the short-term and slow any economic recovery. Given the precarious state of bank asset quality, any attempt by President Ahmadinejad to pressure banks to lend again to select credit-risky borrowers could further endanger the banking sector.
END SUMMARY.

¶2. (SBU) On January 3, the CBI released a report showing delinquent loans jumped in value from USD 40 to 48 billion from mid-September to mid-November. Iranian banks have approximately USD 19 billion in capital, USD 177 billion in deposits, and 188 billion in client loans. Hence, delinquent loans represent approximately 26 percent of all loans carried by Iranian banks, five times the international standard. Additionally, Iran's banking sector has an aggregate asset-to-equity ratio of 18.2, more than two times their GCC counterparts. In fact, USD 48 billion in arrears represents nearly 2.5 times total bank capital. As a result, Iranian banks are in a precarious position and do not have much of a capital buffer to absorb prospective loan losses.

¶3. (U) In a January 3 interview with state news agency Mehr, CBI's Credit Supervision Head Hamid Tehranfar said he believes the current NPL surge is tied to "difficult economic conditions in the country" brought on by the worldwide economic crisis. Additionally, he said he expects to see the number of defaults continue to grow, given that "the country is in a period of stagnation."

¶4. (SBU) Other state institutions argue the problem runs much deeper. Concerns about the amount of delinquent loans and who the borrowers are were first raised by, head of Iran's GIO (under Iran's Judiciary branch Mostafa Pourmohammadi) in mid-October 2009

when he announced that Iranian banks were carrying approximately USD 38 billion in delinquent loans. BBC Farsi reported January 4 that the GIO's investigation showed most loans are held by a small number of borrowers and some of the most toxic are concentrated within an even smaller subset of those borrowers. According to the GOI report, one thousand borrowers hold approximately USD 34 billion in loans with 90 of them collectively responsible for USD 8 billion in unpaid loans.

¶5. (C) According to Iranian economic news daily 'Donya-e Eqtesad', in its report the GIO said "worthless letters of credit and collateral" issued to borrowers as well banks' mismanagement in collecting overdue payments were the reasons for the increase in NPLs. One IRPO business contact provided an example, saying that a number of the bad loans are tied to individuals who received credit using an IRGC guarantee and used the capital to start new businesses. He told us one of his acquaintances, who he said was not an IRGC member, in early 2009 received a loan to import rice on the basis of such an IRGC letter and without collateral. According to our contact, his friend imported the rice, but with the economic slowdown and a surplus of rice in Iran, he has not sold it. Asked about the loan, our contact says the loan remains outstanding though if the rice sells, the friend hopes to re-pay it. If the bank attempts to collect, chances of recouping the loan amount will prove difficult as the bank has no collateral to use as leverage.

¶6. (C) Given the opacity of the Iranian banking sector, it is difficult to determine what percentage of default borrowers are beneficiaries of government cronyism (such as the one our contact

highlighted), but such claims are being made by some senior government officials, who are also regarded as Ahmadinejad's political opponents. According to Donya-e Eqtesad, in a January 3 meeting with officials to discuss delinquent loans Judiciary Head (and brother of Majlis Speaker Ali Larijani) Hojjatoleslam Sadegh Larijani said that the Judiciary "needs to fight this economic corruption." The same article quotes the head of the State Audit Organization as saying the problem stems from "poor management and regulation of banks" as well as lack of transparency.

¶7. (C) In the absence of any official government statement about the delinquencies or change in policy, the CBI has announced that it is considering new regulations, including increased fines and refusal to issue new checkbooks for those with any overdue loan payments. Speculation about such actions plus general concern about political instability seems to be raising popular concern about the health of the banking sector. Reformist website Iran Press News reported December 31 that banks have started to limit the amount of cash withdrawals due to "unprecedented withdrawal of people's cash from banks." In mid-December, the CBI issued a circular giving banks the authority to seize savings or checking deposits from a debtor, guarantor, or "first-degree relative" if the primary debtor had a delinquent loan in order to settle payment.

¶8. (C) Individual actions by banks to try and protect their cash positions while not disclosing their motivations will probably only exacerbate public concern. One IRPO contact told EconOff that on a recent trip to Iran, he asked for a new checkbook at Bank Saderat and was refused due to a new unpublished policy that requires he keep more than the current USD 1500 he has in his checking account to warrant a checkbook. Our contact says in the fifteen years he has had an account at Bank Sederat this is the first time that the bank has tied his right to a checkbook to his deposit balance and raises his suspicion about how "his money is being used."

¶9. (C) COMMENT: It is no secret that state-owned banks were effectively forced to give low-interest loans to (often state-owned) companies to help boost economic growth in recent years. This pressure from the government to lend to credit risky Iranian individuals and companies seems to have come full circle with bad loans now piling up. Enforcement of new standards for loans will most likely cut liquidity across the marketplace in the short-term hurting a broad swath of legitimate, domestic borrowers. A weaker, highly leveraged commercial banking sector dragged down

by state-owned banks will most likely perpetuate economic stagnation and slow any economic recovery in coming years.

¶10. (C) COMMENT (CONT): The lack of a government response to date about the growing problem of bad loans and the poor health of the banking sector also reflects negatively for the sector's long-term future. Even if the government props up the banking sector by injecting further capital, deteriorating asset quality and the potential drawing down of banks' capital accounts will nonetheless constrain their ability to make new loans for the foreseeable future. END COMMENT.
EYRE